



Low Incomes
Tax Reform
Group

A voice for the unrepresented

A future for the low-income taxpayer



Practical steps to
making the tax and
associated welfare
systems work
better for people
on low incomes

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About the Low Incomes Tax Reform Group

The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998 LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes.

About the Chartered Institute of Taxation

The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

Foreword

In spring 2015, 17 years after we started campaigning for a better deal for taxpayers on low incomes, LITRG put our proposals for improving the system together for the first time in a 'Manifesto' that we hoped the next Parliament would implement. We are delighted that several of the proposals in our 'Manifesto' have been taken on board, resulting in a better tax system for everybody. For example: in late 2015 HMRC issued composite notices of coding that included details of all of the payers of an individual's employment or pension income and showed how personal reliefs were allocated – thus minimising errors in the amount of tax deducted from them during the year; the income level for which rent a room relief might be claimed was increased – thus potentially increasing the availability of rented accommodation; and HMRC updated their guidance in relation to special relief – thus facilitating the remission of debts for vulnerable taxpayers where collecting the full amount legally due would be 'unconscionable'. These are all very welcome and positive outcomes.

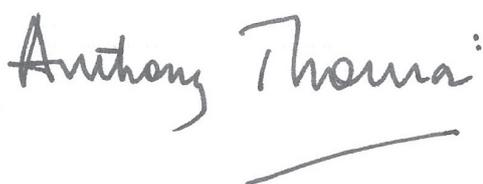
LITRG is grateful to ministers of successive governments, and to civil servants at all levels, for being willing to listen to – and sometimes act upon – our proposals. Despite this there are still many areas where we think changes, sometimes small but crucial to many, could lead to significant improvements for the low-paid and others whom we seek to represent.

This 2017 'wish list' sets out our main recommendations followed by more detailed commentary in seven key areas. All of our proposals for changes to the administration of taxes and legislation aim to improve the position for people on low incomes. Many of these people have complex tax affairs due to having more than one job, receiving state benefits that may or may not be taxable, bereavement, or other changes to their personal circumstances. Any errors or misunderstandings of their tax affairs can and often do lead to debt and associated stress.

Giving a voice to those on low incomes, who usually cannot afford to pay for professional help or advice and often navigate the tax system alone or with the help of volunteer advisers, was the motivation behind the creation of LITRG almost 20 years ago. LITRG brings together former and current tax professionals, including former 'big four' partners and ex-HMRC senior officials who work alongside experts on tax and tax credits from within our own staff. It also includes specialists from other organisations with an interest in this area – such as Tax Help for Older People, itself originally a LITRG initiative (though since 2004 a fully independent charity), and TaxAid.

Naturally and quite properly we cannot take a position on how much tax people should pay, as that is a matter for an elected government. We do, though, seek a tax and benefits system which operates in a way that everyone can navigate easily and which recognises that tailored support is often needed to enable some individuals to comply with their statutory obligations. Consequently, some of our proposed recommendations are geared towards helping the most vulnerable and those who have particular difficulties with the way in which the tax system operates. Other recommendations, such as those affecting self-employed people, would benefit much larger swathes of the population. While some of our proposed recommendations would involve a change in legislation, others require only changes of emphasis to existing guidance or procedures.

We hope that officials will continue to listen to us and take up our recommendations. As always we stand ready to work with all policy-makers and increasingly in the devolved bodies, to assist them in making the tax system work better for all but especially those low income taxpayers.



Anthony Thomas
Chairman

Who needs help with the tax system?

The following broad groups are among those who have the greatest need for help and support in using the tax and tax credit systems. We also provide information for some whose income may not necessarily be low but who encounter particular complexities – this includes the armed forces, and parents and others using childcare support.

Low income employees

The PAYE system keeps tax relatively simple for most people with a single steady job. But it is harder for those with multiple jobs, or moving between jobs, to ensure that the right tax is deducted from every pay packet. As taxpayers are responsible for checking they pay the right tax, HMRC should make this as simple as possible.



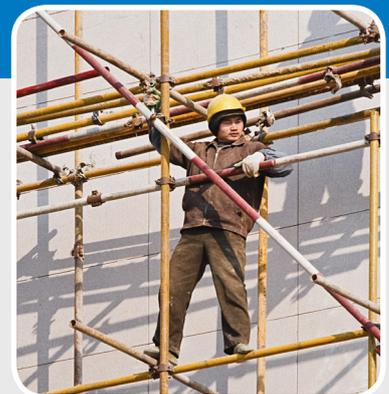
Self-employed workers

Self-employed people must calculate and pay their own tax and National Insurance contributions. This means navigating the complexities of business records, profits, losses, expense deductions and capital allowance claims. Moreover, the rules for benefits and tax credit entitlement are trickier than those facing employees.



Agency and casual workers

Most people are either employed or self-employed, but some find themselves in a grey, often complex, area between the two. Gig workers have an uncertain status although this area of the economy is growing. Agency workers might be treated as employees in tax terms but are 'workers' for employment law. Some might receive in-work state benefits. Agency workers are sometimes persuaded into 'umbrella' arrangements to improve their position, but the result is often that they are in fact worse off and confused. Some workers are forced to set themselves up as self-employed, when in reality it appears that they should be treated as an employee.



Migrants

Those newly arrived in the UK must learn the tax system from scratch. Language barriers may make misunderstandings more common. Any income earned in a home country may cause further tax issues. Complications also arise when people leave the UK.



Pensioners

Perhaps surprisingly, pensioners' tax positions can be complex. Multiple sources of income such as state pension, benefits, occupational pensions, personal pensions, foreign pensions, and income from savings and investments often result in frequent and complicated interactions with government. In addition, resolving tax affairs following a bereavement can be difficult and stressful.



Disabled people and carers

Independent living means that more people with disabilities are employing personal assistants to provide care, with consequent tax and National Insurance responsibilities. Research¹ shows that 'micro' employers such as these are really struggling with the real time information PAYE system, although care and support employers are able to opt to use paper forms rather than reporting online. Carers are also poorly supported, facing difficult interactions between the minimum wages rules, state benefits and tax.

¹ <https://tinyurl.com/HMRC-research-RTI>



Students

Many students work part-time to help finance their studies. Particular tax issues affect mature students, apprentices, volunteers and interns. Many students come to the UK from overseas to study; and UK-based students might study or work overseas for a period of time, resulting in complex interactions with the tax authorities in relation to their country of residence. The repayment of student loans via the tax system and how such repayments are calculated commonly cause confusion.



Digitally excluded

Digital exclusion is often a problem for people on low incomes and cuts across the above groups; but because affordability is not the only factor in digital exclusion, it also affects many other taxpayers. With government's increased emphasis on communicating and interacting digitally, those without the access, skills, motivation or trust to do so may find themselves unable to cope without additional help and support.



Highlights

Our recommendations list is – admittedly – long. Having said that, we think many of the points are achievable in the short term and others are longer term aims. We highlight here some of the overriding themes explored in more detail in the subsequent sections.

Digital

We support HMRC's digital ambitions, but argue the pace of change should be slowed.

People must not be forced to go digital – they should be encouraged and supported to do so; but if they cannot, equal provision should be made for them.

Policymaking

Simplification cannot be achieved by looking at tax alone – it is often the interactions with other areas of law that cause complexity. Extra steps in the policymaking process – to ensure that interactions are seamless and avoiding similar yet subtly different definitions of essentially the same thing – would be of significant benefit.

Tax reliefs

The overriding theme here is that people in similar situations ought to have similar entitlements.

This document highlights various situations in which this is not the case, such as a bar on claiming marriage allowance where one partner has died before a claim is made – particularly anomalous given that a separated couple may still claim; and income tax relief denied to some low-income employees because of their employer's choice of pension scheme.

Helping the self-employed

With increasing numbers of self-employed people, it is essential that the administration systems for them are simple and fair, requiring income to be reported once only. The rules for self-employed claimants of universal credit should be refined so they are cohesive with the tax system and can deal fairly with fluctuating incomes and expenses.

Fairer tax treatment for the low-income population

Many people on low incomes no longer pay tax due to the increased personal allowance. Rather than further increases in the personal allowance, a better way of helping workers on the lowest incomes might be to review and uprate National Insurance thresholds and the universal credit work allowance.

Information

HMRC have lost control of their own information provision, this being centralised via GOV.UK. Efforts should be made to close the gaps in guidance this has opened up, and resolve inaccuracies.

Tax and related benefits information should be an integral part of the public financial guidance delivered by the new single body.

Childcare – interaction between systems

Childcare provides an excellent example of how complex interactions can occur between tax and welfare. With tax-free childcare beginning in 2017, childcare vouchers phasing out from 2018, universal credit rolling out across the UK, and tax credits entitlement remaining alongside universal credit in some cases, individuals might find themselves lost in a maze of 'better off calculations'. That is, if they even appreciate the choice and the danger of financial loss if they get it wrong.

As in many other areas, clear and comprehensive guidance and support is essential.

Summary of Recommendations

1. Digital Matters

We support HMRC's moves to capitalise on the possibilities offered by a digital tax system. To get the most from these changes, HMRC should:

- a. Take digital progress at a pace which taxpayers can keep up with, and ensure that taxpayers understand the changes, through clear communication in a variety of formats (including offline).
- b. Carry out a robust impact assessment of the digital transformation.
- c. Work with the Department for Work and Pensions (DWP) to ensure that claimants of state benefits report income once only and on the same basis for both departments.
- d. Continue to provide official telephone numbers on all correspondence.
- e. Reverse the shift towards discontinuing printable versions of forms.

2. Simplification

- a. Align the primary threshold for National Insurance with the personal allowance.
- b. Refine the rules for self-employed claimants of universal credit, so that: they are cohesive with the tax system; and have flexibility for seasonal business, and businesses with fluctuating income or expenses and one-off expenditure (such as the claimant's tax bill) without them falling foul of the minimum income floor rules. The system should treat self-employed claimants on a par with employees as regards pension contributions when earnings fall below the minimum income floor.
- c. Introduce a formal step in policymaking to avoid introducing new definitions where one already exists in law. Commit to reviewing and aligning definitions as and when changes in the law are made.

3. Education and information for taxpayers

- a. Government Digital Services should work with HMRC and external stakeholders to review the accuracy of, and address any gaps in, GOV.UK tax and tax credits material.
- b. A second, more detailed, layer of information should be added to GOV.UK for taxpayers, claimants and non-expert advisers.
- c. GOV.UK should use an extended validation certification to identify it as a trusted site.
- d. Taxpayers rely upon information on GOV.UK. The site should clearly show when updates have been made, the effect of those changes and where archived copies can be found.
- e. The new public financial guidance body should ensure that the taxation aspects of consumer information are adequately covered. LITRG stands ready to contribute to these changes, as experts in tax and its interactions with welfare benefits.
- f. HMRC should make available appropriate information in hard copy form for new businesses that are not digitally enabled.
- g. Migration from tax credits to universal credit: HMRC and DWP should work together with external organisations to ensure that the changes are communicated properly.
- h. All DWP notifications should make it clear whether any benefit is taxable, and the DWP should provide recipients of state benefits with a clear itemised annual statement showing the total benefits received in a tax year, identifying the taxable elements.

4. Tax-free childcare

- a. The online calculator should be improved to cover a full range of circumstances, including interactions with universal credit. Circumstances not covered should be made clear at the start so claimants are not misled.
- b. Further guidance is needed to cover complex situations and interactions, and there should be a specialist team to provide detailed support and advice.

5. Tax reliefs

- a. Marriage allowance legislation should be amended so that claims may be accepted where one of the spouses or civil partners has died before a claim has been made.
- b. Basic rate tax relief on pension contributions should be made available to all low-income employees.
- c. Government should review how people might rectify their situation if they find themselves with a disproportionate financial loss as a result of a pension lump sum withdrawal.
- d. The possibility of salary sacrifice for those on the lowest income should be reviewed.
- e. Tax relief should be considered for those on the lowest incomes whose expenses of employment are not reimbursed by their employer.

6. Tax and state benefit interaction

- a. Automatically increase the earnings threshold for receiving carer's allowance when the National Minimum or National Living Wage increases.
- b. Future increases in the income tax personal allowance should be mirrored by equivalent changes to the universal credit work allowance, meaning that the lowest earners who do not pay tax gain financially from entering work.
- c. Disregard widowed parent's allowance as income for assessment of universal credit.
- d. Ensure the interactions of benefits and taxation measures are properly considered, by building clear and mandatory steps in the policymaking process.
- e. The UK government and devolved administrations should work together closely to ensure that any changes in welfare systems or taxation do not have unintended financial consequences for claimants.

7. Tax credits compliance

- a. The government/HMRC should commission an independent review of the end-to-end tax credit compliance processes.

1. Digital Matters

The government and HMRC have increased their focus on developing and encouraging people to use digital services. Potential benefits can be identified easily and for those who are able, digital services are the way forward.

We are, however, concerned at the fast pace of change and that people may be **forced** to 'go digital'. The needs of low-income and other vulnerable taxpayers must not be overlooked. Digital exclusion is – and will always remain to some degree – a very real problem. Many people do not have access to the internet, let alone to fast broadband. Others lack skills, perhaps because of age or disability, or are concerned about security or the cost of using digital communications. Even the digitally enabled can become digitally excluded as a result of age, illness, bereavement or advances in technology.

On a number of occasions HMRC have tried to make people use solely digital means to communicate with them.

The 2013 Tribunal case of *LH Bishop Electric Co Ltd & Others v HMRC Commissioners* found that HMRC's requirement that VAT returns be filed online was discriminatory for the appellants who were elderly, disabled or lived in remote areas. This gave legal underpinning to the requirement that practical alternatives to digital communications must be made available.

In 2016, HMRC made great strides towards their digital targets. The purpose of this document is not to revisit our responses to 'Making tax digital' consultations nor to reiterate the recommendations in our own 2016 report, 'Digital services for taxpayers – effectiveness and engagement'.

The following recommendations draw on those documents and our other experiences of moves towards a digital tax system. These are key points to address in order to protect and support the low-income population when pursuing the digital agenda. HMRC should:

1A. Take digital progress at a pace which taxpayers can keep up with, and ensure that taxpayers understand the changes, through clear communication in a variety of formats (including offline).

Not mandating digital channels would achieve this, by allowing taxpayers to migrate naturally. The success of self assessment online demonstrated that this will happen if the service, communications and support are good. Ultimately, every other recommendation below should fall into place if HMRC get this right.

The only way that HMRC will have full control over the delivery and quality of its services is to provide free-of-charge digital services themselves, not rely solely on commercial companies.

Services for the digitally excluded must be of at least the same level as digital services, and should be adequately advertised and promoted, with clear criteria as to who may use them. And while HMRC should offer assistance to engage digitally, people must not be forced to do so (either through legal mandation or HMRC omitting essential information from communications and asking the taxpayer to go online for further information). Nor should people be expected to rely on friends, family or others to help them do so.

It should be made easy to appoint a 'trusted helper' for those who wish to do so to assist them with digital services. A clear first step towards this would be to make this available via the Government Gateway, not just through GOV.UK Verify.

Confusion should be minimised by clearly explaining the routes to accessing HMRC online services. Security of data and individuals' accounts is paramount. Currently, the different means of confirming identity either through GOV.UK Verify or the Government Gateway seems to be an unnecessary complication.

1B. Carry out a robust impact assessment of the digital transformation.

This needs to be done to ensure that the costs to taxpayers of digital reporting and communications are not disproportionate to the benefits. It must assess equality issues, and be under continual review.

1C. Work with the Department for Work and Pensions (DWP) to ensure that claimants of state benefits report income once only and on the same basis for both departments.

Those on the lowest incomes should not be faced with multiple rules and different systems.

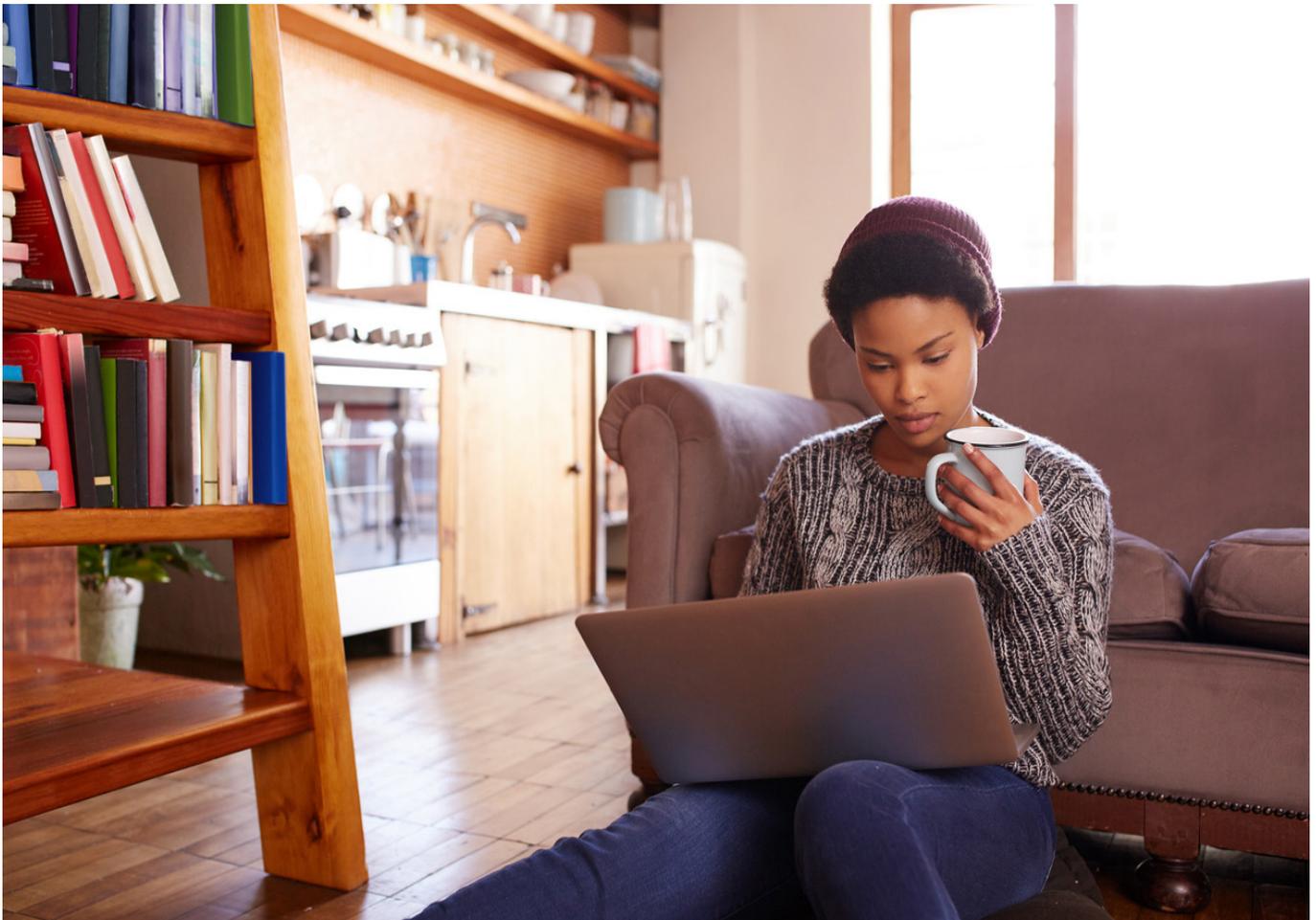
1D. Continue to provide official telephone numbers on all correspondence.

We have seen a trend of HMRC omitting helpline numbers from correspondence. The risks of not providing the official number are, for example that people:

- will not understand what the written communication is saying, and will not know how to find out if they cannot ring;
- may fall foul of 'copycat' websites and phone numbers that connect to HMRC but at a greatly increased cost.

1E. HMRC should also reverse their shift towards discontinuing printable versions of forms.

This trend is making life unnecessarily difficult for those trying to help others who are digitally excluded, such as voluntary organisations.



2. Simplification

Taxpayers have the right to be able to understand easily what their rights and obligations are. Legislation is often very difficult or impossible for an unrepresented person to understand and it is therefore crucial that systems and guidance help everyone to navigate their tax and benefits. It should

not be necessary for anyone to have to spend money on professional advisers or software simply to comply with the law.

We therefore explain our recommendations in this area as follows:

2A. Align the primary threshold for National Insurance with the personal allowance.

Employees (and in the future the self-employed) start paying National Insurance contributions (NIC) when they earn at a level higher than the primary threshold (£8,060 per year for 2016/17), but they do not pay income tax until they earn £11,000 per year (for 2016/17).

This seems anomalous and is poorly understood. It means that those on the lowest earnings, who obtain no benefit from an increase in the personal allowance, still may have to pay NIC. Raising the primary threshold to the level of the personal allowance would benefit all taxpayers below retirement age, but it would benefit most those on the lowest incomes. Entitlement to state benefits could be maintained by preserving the lower earnings limit at around its current level.

2B. Refine the rules for self-employed claimants of universal credit, so that: they are cohesive with the tax system; and have sufficient flexibility for seasonal business, and businesses with fluctuating income and/or expenses and one-off expenditure (such as the claimant's tax bill) without them falling foul of the minimum income floor rules. The system should treat the self-employed on a par with employees as regards pension contributions when earnings fall below the minimum income floor.

HMRC relies on a series of tests to decide whether or not an individual is trading as a self-employed person. These so-called 'badges of trade' have been devised and refined over many years through case law. However, the DWP make their own determination about whether a claimant is carrying on a trade and although the tests are based on the HMRC 'badges of trade' they are not bound to follow the HMRC decision. They also impose separate tests to determine whether a taxpayer is gainfully self-employed for the purposes of universal credit. We urge HMRC and DWP to work together so that both departments would agree whether an individual was self-employed, although we recognise that a separate test to determine whether that self-employment was gainful might be necessary

Universal credit is based on monthly assessment periods (as opposed to income tax and tax credits that look at annual results) and this can lead to particular difficulties for the self-employed. We highlight the following main areas of concern:

- Universal credit requires claimants to report their income on a monthly cash basis. This cash basis is different from that operated by HMRC and will cause confusion. We noted above that reporting requirements for the self-employed for tax and universal credit should be aligned.
- After an initial start-up period of 12 months (which we would prefer to see extended to at least 24 months), universal credit claimants are to be subject to the minimum income floor – in other words they will be assumed to earn a minimum level of income each month. This is extremely unfair on those who are involved in seasonal businesses, for example farmers, those who have fluctuating income and/or expenses and also those who incur a large expense (which may even be the claimant's self assessment tax bill, since universal credit is calculated on net income) in a particular month and may incur a loss. Income could instead be averaged over a relevant period, up to 12 months.
- From April 2018, it will be possible to carry some losses forward in universal credit; at present it is not. But even if a loss is carried forward to a subsequent assessment period, the minimum income floor will still apply, thus restricting the loss relief.
- Where a claimant's income increases and they cease to qualify for universal credit, they are deemed to have 'surplus' earnings. These surplus earnings can be carried forward to restrict any claims in the following six months. This can be very unfair to a claimant who, perhaps, picks up significant additional work over Christmas and then finds their subsequent claims restricted for several months. While the surplus earnings policy applies to both the employed and self-employed, it is particularly harsh on the self-employed because they are subject to the minimum income floor.
- At present the minimum income floor is calculated after deductions for notional tax and national insurance but it ignores pension contributions. This creates unfairness between the employed and self-employed. If the minimum income floor is to be retained, it should be amended so that it is calculated after deduction of pension contributions. The examples of Aaron and Derek – comparing a self-employed person to an employee in similar circumstances illustrates the problem.



Example 1 ***Aaron and Derek***

Aaron is a self-employed builder – his self-employed monthly income for January 2017 is £1,092. His notional tax and National Insurance will be £85.51.

Derek works in a call centre for 35 hours a week at the National Living Wage (£7.20 per hour for 2016/17). His monthly income is also £1,092 and he has deductions of tax and National Insurance of £85.51 in that assessment period.

Aaron and Derek will both receive the same amount of universal credit in January 2017, assuming their circumstances are both the same.

In February 2017, Aaron and Derek both decide to pay £75 a month into a private pension. Derek will have his universal credit calculated on his new net income of £931.49 (£1,092 gross less tax and National Insurance of £85.51 and pension contributions £75) whereas Aaron will have his universal credit calculated on £1,006.49. This is because Aaron's actual income of £931.49 is lower than the minimum income floor of £1,006.49.

This means that Derek will receive nearly £50 a month more universal credit than Aaron despite them having the same earnings each month and making the same pension contributions. Aaron is therefore not given any recognition for his pension contributions.



2C. Introduce a formal step in policymaking to avoid introducing new definitions where one already exists in law. Commit to reviewing and aligning definitions as and when changes in the law are made.

It is not surprising that the public are confused about tax and benefits. When they think they have understood what ‘income’ is in relation to HMRC’s definition of the term, they may then discover that a different definition is used – for example, in order to establish entitlement to universal credit or in calculating the amount of their student loan repayments.

Similarly, our report ‘Couples in the tax and related welfare systems – a call for greater clarity’ illustrates the difficulties of different definitions being used of what is a couple for tax, tax credits and benefits purposes.

We acknowledge that it may be difficult to align existing definitions without a great deal of work and assessment of winners and losers, but it is possible to avoid introducing new or subtly different definitions of the same term in different contexts.

Introduce a formal step in policymaking to avoid introducing new definitions where one already exists in law. Commit to reviewing and aligning definitions as and when changes in the law are made.

3. Education and information for taxpayers

If taxpayers can understand the basics of the system and the rationale behind paying tax, they are better able to check they pay the correct amount of tax and to understand the reasons for doing so. The PAYE system remains a mystery to most employees. While the introduction of the new P2 (notice of coding) is likely to have improved this understanding, much more could be done. With the introduction of personal tax accounts and more emphasis being put on the responsibility of taxpayers to check that the information held by HMRC is correct, it is crucial that they have adequate and accessible guidance.

We explain our recommendations below:



3A. Government Digital Services should work with HMRC and external stakeholders to review the accuracy of, and address any gaps in, GOV.UK tax and tax credits material.

Tax and tax credits information on GOV.UK has been over-simplified compared with what used to be on the HMRC website. It is also updated without any 'marker' being left, so that somebody might rely on what they read one day only to find that it has changed. There is then no way of discovering easily when a change was made.

Some of the information on the GOV.UK website is technically incorrect. In some instances, despite this being pointed out, no remedial action has taken place. For example, the following two problems – one on the marriage allowance and one on tax credits – existed at the time of writing:

Marriage allowance

To claim this allowance, neither spouse (or civil partner) must pay tax at a rate higher than the basic rate. The narrative on GOV.UK reads:

'To benefit as a couple, you (as the lower earner) must have an income of £11,000 or less.'

This is clearly incorrect and, despite providing feedback on the page itself and advising HMRC of the error, no change has been made. This is, no doubt, stopping eligible people such as Tim and Moira in our example from making claims that could improve their financial position.

The availability of marriage allowance should be better publicised along with guidance on how to claim it non-digitally. Guidance on GOV.UK must be corrected and made more comprehensive.



Example 2

Tim and Moira

Tim is married to Moira. In the 2016/17 tax year, Tim has earned income of £20,000, whereas Moira has earned income of £10,000 and dividend income of £5,000. In other words her total income is £15,000.

If no claim to marriage allowance is made, her tax liability is calculated as follows:

Earned income	£10,000
Personal relief	£10,000
Taxable	nil
Dividend income	£5,000
Personal allowance	£1,000
Taxable	£4,000

All of her dividend income is taxable at 0%, though, due to the dividend allowance. So she has no tax to pay.

Tim's tax liability is as follows:

Earned income	£20,000
Personal allowance	£11,000
Taxable	£9,000
Tax due at 20%	£1,800

Contrast that with when a claim to marriage allowance is made:

Moira's tax liability is now

Earned income	£10,000
Personal allowance (£11,000 - £1,100)	£9,900
Taxable	£100
Tax payable	£20

Tim's tax liability is now:

Earned income	£20,000
Personal allowance	£11,000
Taxable	£9,000
Tax due	£1,800
Less: marriage allowance credit	£220
Net tax due	£1,580

This couple would be £200 better off by claiming the marriage allowance, but GOV.UK indicates that they cannot benefit from claiming.

Tax credits

When a tax credit claim is made, income for the past year must be disclosed. In order to check what income details to give, a claimant may go to GOV.UK to check whether their income-based jobseekers allowance should be included.

GOV.UK advises 'Income includes money from UK state benefits (or their foreign equivalents) unless they're 'tax-free' benefits.' This narrative contains a link to another page headed 'Tax free and taxable state benefits'. This latter page confirms that jobseekers allowance is taxable. It is, but income-based jobseekers allowance is specifically excluded from being counted as income for the purpose of tax credit claims. So the guidance on GOV.UK is misleading and could mean people over-declare their income resulting in a loss of tax credits.

3B. A second, more detailed, layer of information should be added to GOV.UK for taxpayers, claimants and non-expert advisers.

If this is not possible, it would at least be helpful to include links to HMRC and DWP technical materials within the guidance aimed at the general public, if the visitor does want or need more information.

3C. GOV.UK should use an extended validation certification to identify it as a trusted site.

A major issue for internet users is determining which sites are trustworthy and which are scams. Hosting information under the GOV.UK banner helps build this confidence, but an extended validation certificate would give users further confidence.

3D. Taxpayers rely upon information on GOV.UK. The site should clearly show when updates have been made, the effect of those changes and where archived copies can be found.

People should be able to trust the information published on GOV.UK and not be penalised if they have acted in reliance on it. For example, when assessing inaccuracy penalties for an unrepresented taxpayer, HMRC officers should ask the taxpayer whether they looked at GOV.UK and if so what information they relied upon. After all, one must presume that HMRC would rather educate taxpayers to do the right thing than penalise them for getting it wrong. If they did not know they should check GOV.UK for guidance, or indeed did so but misunderstood what they found or relied on inaccurate or incomplete information, this might lead to the conclusion that they took reasonable care to get things right.

3E. The new public financial guidance body should ensure that the taxation aspects of consumer information are adequately covered. LITRG stands ready to contribute to these changes, as experts in tax and its interactions with welfare benefits.

In 2016, the government announced that it would introduce a new single public financial guidance body. We applaud this proposal since consumers need to be able to consider their financial affairs in an integrated manner rather than in silos. Tax can make a significant impact on any such decision, so needs to be an integral part of the guidance.

3F. HMRC should make available appropriate information in hard copy form for new businesses that are not digitally enabled.

On starting a business, the owner needs to understand their record-keeping and HMRC reporting responsibilities. There is a large amount of information online for new businesses, including webinars. For the digitally excluded business, though, there is a lack of written information and phoning HMRC could prove costly. It can be difficult to visualise how accounting records might be kept if the taxpayer has no previous experience and nothing to refer to. A leaflet would be very useful, such as that which HMRC used to issue to new businesses. A snapshot of GOV.UK showing all HMRC leaflets available shows there are none available to help new businesses.

Moreover, as self-employment morphs into non-traditional shapes, for example, those ‘freelancing’ for piece work in the gig economy, HMRC should produce more tailored guidance and support to those groups – both online and in paper format.

3G. Migration from tax credits to universal credit: HMRC and DWP should work together with external organisations to ensure that the changes are communicated properly.

Latest indications suggest that the DWP will increase the availability of the universal credit service during 2017/18 and this will bring about a corresponding reduction in the availability of new claims for tax credits, largely on a geographical basis. At the same time, new policies are being introduced into both schemes to limit the amounts payable for children when there are more than two children in a household.

3H. All DWP notifications should make it clear whether any benefit is taxable, and the DWP should provide recipients of state benefits with a clear itemised annual statement showing the total benefits received in a tax year, identifying the taxable elements.

Recipients of state benefits often think these have no effect on their tax liability. For example, the state pension is taxable but many people do not know that. The situation is complicated because sometimes more than one benefit is paid as a single sum. For example, the Christmas bonus is not taxable but many people might assume that it is since it is paid along with the state pension.

There are many other taxable state benefits, but awareness of them being taxable is low. This can cause significant distress when an unexpected tax liability is notified, often some time after the benefit was originally received.

DWP letters notifying state benefits should show clearly whether that benefit will be subject to income tax and if so, outline any obligation to notify HMRC or to check that tax paperwork (such as a PAYE coding notice) includes the correct amount. Any subsequent notifications about the benefit should confirm this guidance.

Each employer and pension provider paying taxable sums, no matter how small, is required to produce annual statements showing the total paid in a tax year, etc. It is unacceptable that the DWP, the largest payer of such benefits, does not have to do so. Even if these benefits are pre-populated in future on individuals’ digital tax accounts, there will still need to be a clear statement of how the figure on the screen was arrived at so that the taxpayer can check they agree with it.

4. Tax-free childcare

The introduction of the tax-free childcare scheme has been delayed until 2017 (from its initial launch date of October 2015).

While we support the concept of tax-free childcare and the government's aim to help people with childcare costs, we are concerned about the complexity that has been created in the area of childcare support. Some of these complexities are:

- Those who currently receive childcare vouchers from their employers will need to decide whether to remain in receipt of vouchers or to move to tax-free childcare.
- Tax credit and universal credit claimants will need to decide whether to remain in

receipt of those benefits or move to tax-free childcare. Most tax credit and universal credit claimants will be better off staying where they are, assuming their circumstances do not change, but they will not know this without doing some difficult 'better-off' calculations.

- New claimants will need to decide which childcare support scheme to apply for and will have to understand how free childcare provision and other childcare support (such as through housing benefit or student support) interacts with tax-free childcare, tax credits and universal credit.

To address these problems, our recommendations are:

4A. The online calculator should be improved to cover a full range of circumstances, including interactions with universal credit. Circumstances not covered should be made clear at the start so claimants are not misled.

HMRC have recently introduced a calculator that compares tax-free childcare with tax credits and employer-provided vouchers, but further work is needed to ensure the calculator produces accurate results and can deal with complex situations. It is disappointing that the calculator does not include universal credit.

4B. Further guidance is needed to cover complex situations and interactions, and there should be a specialist team to provide detailed support and advice.

There is potential for claimants to lose out financially if they do not understand the different schemes well enough to make an informed decision. Consideration should be given to how claimants will be supported further. There will be some who, in order to choose the best option for them, must understand not only the different schemes but also the financial impact on their circumstances. At present it is not clear who in government, if anyone, would be able to offer such support or advice. We recommend the tax-free childcare helpline includes a number of specialists who are able to provide more detailed support and advice.



5. Tax reliefs

This section summarises some areas of the tax system where we have received a number of enquiries from members of the public, and – in some instances – the tax profession, which indicate there are problems and perhaps unintended consequences arising.

Our recommendations and background to each are summarised below:



5A. Marriage allowance legislation should be amended so that claims may be accepted where one of the spouses or civil partners has died before a claim has been made.

The marriage allowance legislation stops a claim being made following the death of one of the spouses or civil partners, for a period before the date of death.

This inability for a personal representative to enable the allowance to be transferred on behalf of the deceased taxpayer, or for the surviving spouse or civil partner to transfer the allowance to their deceased partner seems anomalous – especially since spouses (or civil partners) who are separated can make such a transfer up to the time of any divorce.

5B. Basic rate tax relief on pension contributions should be made available to all low-income employees.

With auto-enrolment, many more low-income workers are now members of employer-provided pension schemes. Depending on the choice made by the employer, there are two methods by which low-income workers may obtain tax relief on their pension contributions. They may be part of a 'net pay scheme', meaning that their 'gross' pension contribution is deducted from their pay before tax is calculated, or they may be part of a 'relief at source' scheme and contribute the 'net' amount to the pension scheme, with the scheme reclaiming basic rate tax on the contribution made.

For the lowest paid, this creates an inequity. For example, those not due to pay income tax on their pay because they earn less than the personal allowance would obtain no tax relief if their pension contributions were collected via the net pay scheme; but if their contributions were paid 'net' to a relief at source scheme the pension scheme administrator could reclaim basic rate tax on the contributions made, thus increasing the value of their pension contribution.

Employees themselves have no control over this – it is down to the employer and their pension scheme operator as to which method of tax relief is applied.

5C. Government should review how people might rectify their situation if they find themselves with a disproportionate financial loss as a result of a pension lump sum withdrawal.

The new rules enabling defined contribution pensions to be accessed flexibly from 6 April 2015 has resulted in more people taking lump sums from their pensions, sometimes with unexpected consequences, such as:

- creating a large tax liability that might have been avoided if they had deferred or staggered receipt of the lump sum
- unwittingly triggering a high income child benefit charge due to the one-off increase in income from drawing a pension lump sum
- finding that their claims to tax credits or universal credit have been significantly reduced.

We have also heard of instances where people have unwittingly reported their income for tax credits as being inclusive of the tax-free element of their pension.

Those with larger pension pots are arguably more able to pay for financial advice. Those on lower incomes might choose to make a withdrawal that is significant with regard to their overall financial position without fully understanding, or even considering, the consequences of their actions. On the other hand, savers who withdraw sums from their flexible individual savings accounts (ISAs) may replace those sums in the same tax year without compromising the status of the ISA.

Taxpayers might, for example, be given the option to replace sums into a pension and such replacement could negate the earlier withdrawal for all tax, tax credits and benefits purposes. Such replacement of funds would not, of course, attract tax relief nor be treated as a contribution for the purposes of calculating income for tax credits and means-tested benefits purposes. The government should consult on this, or other possible options, to ensure that those affected end up in an overall 'just and reasonable' position, rather than them being left out of pocket due to the unintended consequences of their actions arising purely because they did not understand the complex interactions of the systems.

5D. The possibility of salary sacrifice for those on the lowest income should be reviewed.

The rules on salary sacrifice are to be changed through legislation to be introduced in Finance Bill 2017, but these will still allow salary to be sacrificed for childcare vouchers, for example. This saves both income tax and NIC for the employee. This can represent a small but significant saving for those on low incomes where the cost of childcare can be significant relative to their earnings.

Unfortunately the National Minimum and Living Wage rules do not allow salary to be sacrificed where it would mean the cash payment received by the employee was less than the statutory minimum. This deprives this group of taking advantage of something that would be available to those on a higher income.



Example 3 *Jenny*

Jenny works for 35 hours a week and is paid the National Living Wage, meaning her gross salary each week is £252 (until the rate changes in April 2017). Assuming she has no other income she would pay tax of approximately £8 per week and NIC of approximately £12 per week. From her net wage of £232 a week, she pays childcare costs of £55 per week, leaving her with £177.

If she were allowed to participate in a salary sacrifice scheme for the maximum amount of £55 per week for childcare vouchers, her cash salary would fall to £197 per week, meaning she no longer had any tax to pay while her National Insurance bill would reduce to £5 per week. Overall she would have cash of £192 after childcare costs – £15 a week more than if she had not participated in the scheme.

5E. Tax relief should be considered for those on the lowest incomes whose expenses of employment are not reimbursed by their employer.

The rules surrounding travel expenses for employees are complex – but, broadly an employee can deduct travel costs, that are not reimbursed by their employer, from their income for tax purposes if they are necessarily incurred in performing their job. This provides them with tax relief on those costs, but not relief from National Insurance costs, thus saving 20% of the cost for a basic rate taxpayer.

The position for a non-taxpayer, though, is that they obtain no tax relief on such costs. Many care workers find themselves in this situation.



6. Tax and state benefits interaction

Ensuring that the tax and welfare systems work together fairly means that individuals will be less likely to be penalised when moving from benefits into work. Government must be mindful that sometimes the receipt of one state benefit can be influenced by the receipt of another and changing the criteria for one benefit, or even changing the rate at which it is paid, can significantly alter an

individual's financial position.

Equally, changes to the tax system might create complications for welfare benefits claimants.

The following would go some way to improving the way that tax, state benefits and other related systems interact:

6A. Automatically increase the earnings threshold for receiving carer's allowance when the National Minimum or National Living Wage increases.

Broadly carer's allowance is payable at the rate of £62.10 per week to individuals who care for another individual for at least 35 hours per week, providing the cared-for individual receives certain benefits. One of the conditions is that the claimant must earn less than £110 per week.

Until the increase in the National Minimum Wage to the National Living Wage in April 2016, the carer could work 16 hours at the National Minimum Wage and earn less than £110 per week. The 16 hour threshold is important as it may enable the carer to qualify also for working tax credit. Due to the increase to the National Living Wage from April 2016, an individual working the same number of hours would earn £115.20, thus forfeiting all of their carer's allowance. This is clearly inequitable and almost certainly unintended.

6B. Future increases in the income tax personal allowance should be mirrored by equivalent changes to the universal credit work allowance, meaning that the lowest earners who do not pay tax gain financially from entering work.

Subject to certain conditions, universal credit is paid to both the unemployed and to those in work. An individual with limited capability for work or who cares for a child can earn a certain amount, the 'work allowance', before their universal credit entitlement is cut.

Many of those eligible for the 'work allowance' are low-paid and do not pay tax. As a result, an increase in the personal allowance makes no difference to their take-home pay. But an increase in the 'work allowance' would increase their take home pay by increasing the amount of universal credit they could retain, thus ensuring that work pays more than remaining reliant on welfare.

6C. Disregard widowed parent's allowance as income for assessment of universal credit.

Widowed parent's allowance is a benefit paid to parents whose spouse or civil partner has died, leaving them to care for children. The allowance recognises that bereaved children may require additional support when they lose a parent. The benefit is taxable, but in addition it is also classed as 'other income' for the purposes of universal credit. This means that the allowance will be deducted in full from any universal credit award. The interactions are complex because of the ability to earn a certain amount before benefits are restricted, the 'work allowance'. Although claimants may not be worse off by making the claim, they may not be better off, depriving grieving families of any additional financial support. Although new claims to it will cease, widowed parent's allowance will continue to be paid to existing claimants even after the introduction of bereavement support payment in April 2017.

6D. Ensure the interactions of benefits and taxation measures are properly considered, by building clear and mandatory steps in the policymaking process.

Ways of doing this would be: to have a standard question in all consultation documents inviting comments on what impact the measure might have on other areas of law or administration; and to ensure that, for measures affecting individuals, tax information and impact notes have a section dedicated to interactions with welfare benefits and other areas of government.

6E. The UK government and devolved administrations should work together closely to ensure that any changes in welfare systems or taxation do not have unintended financial consequences for claimants.

The interactions described above may assume even greater prominence once the devolved administrations have more control over their own spending budgets. Great care will need to be taken that people are not caught in the middle, between central and local policy and administration.

7. Tax credits compliance

Failures in customer service and a poor quality of decision-making involved in tax credit investigations were highlighted when, in late 2017, HMRC cancelled their contract with their private sector partners, Synnex-Concentrix, who had been tasked with undertaking a programme of tax credit investigations on behalf of HMRC.

A subsequent report by the Work and Pensions Committee was highly critical of HMRC's handling of the contract, the poor levels of customer service and the standards of decision making particularly in undisclosed partner investigations. In response to that report, HMRC undertook to review their processes ahead of the 2017 High Risk Renewals exercise.

Although HMRC will no longer be using Concentrix for the 2017 High Risk Renewals exercise, numerous concerns remain about certain aspects of tax credit investigations. We are particularly concerned about undisclosed partner investigations – where a person has claimed as a single person but HMRC believe they should have made a joint claim. HMRC's planned improvements, including more contact with claimants through the investigation process, all seem reasonable and sensible and should go some way to making the process work better. But given the very tight deadlines before the 2017 exercise begins it will not be easy to change the ingrained culture amongst staff and shift the direction of these investigations.

We strongly recommend that:

7A. The government/HMRC should commission an independent review of the end to end tax credit compliance processes.

Full regard should be had in this review to the concerns raised in our 'Management of tax credits compliance cases' briefing paper published on 1 December 2016.

Flowing from such a review, we would like to see HMRC:

- improve their guidance for claimants so that they can better understand HMRC's rules about how to decide whether or not a claimant is part of a couple, and so should make a joint claim
- a more transparent and considered investigative process on HMRC's part, so that claimants can more easily understand the charge made by HMRC when they are accused of claiming in the wrong capacity
- consider, in a fair and balanced way, all the relevant evidence provided by the claimant to help HMRC understand the claimant's position before making a decision on entitlement. To date it appears that too much weight has been placed on financial evidence to the exclusion of other evidence and claimants have been asked to produce evidence that could not support any decision.